

# Forward Averaging

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## INCOME TAX

Financial Series



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**Ce dépliant est aussi disponible en français sous le titre «Étalement du revenu».**

This leaflet is only a guide. For official purposes, please refer to the Income Tax Act.

Copies of this leaflet are available free of charge from district taxation offices.

## What it is

Forward averaging provisions allow qualifying taxpayers an election to spread certain eligible income received in the current year over future years when they may be in a lower tax bracket.

This eligible income is excluded in calculating taxable income but tax is nevertheless paid on it, at the highest marginal rate as later explained. The eligible income and the tax paid on it is carried forward to following years.

A taxpayer may then elect to report all or any part of this income in any subsequent year and claim an appropriate share of the taxes previously paid as a **credit** against tax otherwise payable in that year. If the taxpayer's income (including the amount brought back into income) has declined to the point where the taxpayer is in a lower tax bracket than in the year of forward averaging, a tax savings will result.

An election may be made in any year that a taxpayer qualifies.

## How it works

Suppose that you have received a large amount of income or a lump sum payment in a year:

- First, you must determine whether you qualify for forward averaging and your income is eligible, as explained later in this leaflet.
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- Then you file an election to forward average some or all of your eligible income, which cannot be less than \$1,000 (using form T540).
  - The amount you designate, your elective income, is excluded in calculating your taxable income for the year of forward averaging. Instead, this excluded amount is taxed federally at 34 per cent and provincially at the current rate for your province.
  - The amount of your elective income will be carried forward until such time as you elect to draw on it. Amounts involved in future years' elections will be added to your balance. Each year an indexing factor based on changes in the Consumer Price Index will be applied to keep your elective income on a current dollar basis.
  - The resulting amount constitutes your accumulated averaging amount.

## **Who qualifies for forward averaging?**

To qualify for the forward averaging election, you must meet the following requirements:

- you must be a resident or "deemed" resident of Canada throughout the year of averaging plus the two immediately preceding years;
  - you must have income eligible for forward averaging, as explained below;
  - you must pay all due taxes, interest and penalties within 30 days from the mailing date of your Notice of Assessment for the year of averaging; and
  - you must have filed a return for each year in the averaging period for which tax was payable. An "averaging period" normally consists of the three years preceding the year of averaging throughout which you were resident in Canada.
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## **If you didn't file a return...**

If you have not filed a prior year return or returns for which tax is payable, you will still be eligible if the missing return(s) are filed on or before the due date for your return for the year of averaging.

If you have not filed a prior year return or returns because no tax was payable, provide details of your income on the forward averaging election form T540.

## **Determining your eligible averaging income**

Most taxpayers can determine the amount of their eligible averaging income as follows:

- 1** Determine your Net Income for 1984 (line 224 of your return).
- 2** Determine your Adjusted Income (as explained below).
- 3** Deduct your Adjusted Income from your Net Income.
- 4** Determine your Taxable Income before any deduction for forward averaging (line 256 of your return).

Your eligible averaging income is the amount determined in (3) or (4) above, whichever is less, provided it exceeds \$1,000.

## **Calculating your adjusted income**

- 1** Multiply your Net Income for each of the three preceding years by the applicable indexing factor below (based on changes in the Consumer Price Index) to arrive at your Revised Net Incomes:
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Year	Net income		Indexing factor		Revised net income
1983	\$ _____	×	1.071	= \$	_____
1982	\$ _____	×	1.193	= \$	_____
1981	\$ _____	×	1.339	= \$	_____
			Total:	\$	_____

- 2** Divide the total of your Revised Net Incomes by three to arrive at the Average Revised Net Income:

Total Revised  
Net Income: \$ \_\_\_\_\_ = \$ \_\_\_\_\_  
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- 3** Multiply the Average Revised Net Income by 110 per cent to arrive at your Adjusted Income:

Average  
Revised  
Net Income: \$ \_\_\_\_\_ × 110% = \$ \_\_\_\_\_

If you were not a Canadian resident throughout 1981, enter NIL in the relevant Net Income column in step 1 and reduce the divisor in step 2 to two.

If you can't find the information you need to complete the adjusted income calculation, you may obtain it from your district taxation office. Please allow sufficient lead time when making your request as your prior years' returns may have to be retrieved from storage.

## Special rules for certain taxpayers

Special rules apply to taxpayers who have included in their income a prior year's capital gains reserve, or who are reporting income from their ac-



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tivities as an athlete, musician or public entertainer or from the production of a literary, dramatic, musical or artistic work. Such taxpayers are allowed to substitute the full amount of income from these sources for the amount determined in step 3 above.

## **How to make an election**

To make a valid election to forward average eligible income, obtain form T540 from your district office and file it with your tax return on or before April 30. This form contains all the calculations required to make your election.

You must pay a federal and provincial forward averaging tax on the amount you have elected to exclude from your regular income. The federal tax is 34 per cent of your elective income. The provincial tax is calculated by multiplying the federal tax by the basic provincial tax rate, and adding any surtax applicable in your particular province.

The balance of your income will be taxed at whatever rate is appropriate, after you have calculated your normal deductions, exemptions and credits.

## **You'll be on record**

Revenue Canada, Taxation will keep detailed records of the accumulated averaging amounts of taxpayers making the election. Your initial election will be recorded by the computer and the amount will be adjusted by any amounts you draw back into income or amounts you add in subsequent elections. The annual indexing factor will be applied automatically.

Each year you will be notified automatically of the amount you elected to forward average in the previous year, your accumulated averaging amount, and your adjusted income for any forward averaging election you may want to make in the current year. If you do not receive this information by the middle of March, get in touch with your district office.

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## **... and how to draw on your accumulated averaging amount**

You may elect to draw on your accumulated averaging amount in any future year throughout which you are resident in Canada. It's up to you to determine the most beneficial time for bringing amounts back into income; most people will do so when their income is very low.

To draw amounts from your accumulated averaging amount back into income, just decide how much you want to include in your income. Complete form T581, available from your district office and file it with your tax return by April 30 at the latest. Enter on line 225 of your return, the amount you want to withdraw and add this amount to your Net Income. On line 458 of your return, enter the total federal and provincial forward averaging tax credit to which you are entitled. The federal credit will be 34 per cent of the amount you are reporting on line 225. The provincial credit will be the amount of the federal credit multiplied by the basic provincial tax rate for the province in which you reside on December 31 of the year you elect to draw on your accumulated averaging amount. This is so even if you resided in a different province at the time you made your original forward averaging election.

This may have the effect of reducing your tax payable or increasing your refund for the current year.

## **When a taxpayer dies**

There is no limit on the length of time an amount may remain in an accumulated averaging account. However, the entire accumulated averaging amount will normally be brought into income for the year of death. The trustee or executor of the estate may, however, decide to exclude all or part of the amount from income and have the excluded amount taxed

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at a reduced rate under special provisions. This treatment will be available for deceased taxpayers who were resident in Canada throughout the year of death until the date of death.

## District taxation offices

### NEWFOUNDLAND

- 01 - 165 Duckworth St.  
St. John's, Nfld.  
A1C 5X6  
Local calls: 772-5050  
Long distance calls:  
1-772-5060

### PRINCE EDWARD ISLAND

- 02 - 90 Richmond St.  
Charlottetown, P.E.I.  
C1A 8L3  
Local calls: 566-7200  
Long distance calls:  
1-566-7200

### NOVA SCOTIA

- 03 - 1557 Hollis St.  
Halifax, N.S.  
B3J 2T5  
Local calls: 426-2210  
Long distance calls:  
1-426-3360

- 04 - 60 Dorchester St.  
Sydney, N.S.  
B1P 6K3  
Local calls: 564-7080  
Long distance calls:  
1-564-7081

### NEW BRUNSWICK

- 05 - 65 Canterbury St.  
Saint John, N.B.  
E2L 4H9  
Local calls: 648-4600  
Long distance calls:  
1-800-222-9622

786 King Ave.  
Bathurst, N.B.  
E2A 1R5  
Local calls only: 548-4407

### QUEBEC

- 06 - 165 Pointe aux Lievres St. S.  
Quebec, Québec  
G1K 7L3  
Local calls: 648-3180  
Long distance calls:  
- From area code 418, dial  
1-800-463-4421  
- From area code 819, dial  
1-800-463-4413

55 Racine St. E.  
Chicoutimi, Québec  
G7H 1P9  
Local calls only: 545-1912

411 Sirois St.  
Rimouski, Québec  
G5L 8B2  
Local calls only: 722-3111

1055 des Forges Blvd.  
Trois Rivières, Québec  
Local calls only: 373-2723

- 07 - 50 Couture St.  
Sherbrooke, Québec  
J1H 5L8  
Local calls: 565-4888  
Long distance calls:  
1-800-567-6184

- 08 - 305 Dorchester Blvd. W.  
Montréal, Québec  
H2Z 1A6  
Local calls: 283-5300  
Long distance calls:  
Zenith 0-4000

- 46 - 3131 St. Martin Blvd. W.  
Laval, Québec  
H7T 2A7  
Local calls only: 283-5300

- 47 - 5245 Cousineau Blvd.  
St. Hubert, Québec  
J3Y 7Z7  
Local calls only: 283-5300

- 09 - 11 Terminus St. E.  
Rouyn, Québec  
J9X 3B5  
Local calls: 764-5171  
Long distance calls:  
Zenith 0-4000

### ONTARIO

- 10 - 360 Lisgar St.  
Ottawa, Ont.  
K1A 0L9  
Local calls: 598-2275  
Long distance calls:  
- From area code 613, dial  
1-800-267-8440  
- From area code 819, dial  
1-800-267-4735

- 11 - 385 Princess St.  
Kingston, Ont.  
K7L 1C1  
Local calls: 542-2831  
Long distance calls:  
1-800-267-0922

- 12 - 11 Station St.  
Belleville, Ont.  
K8N 2S3  
Local calls: 962-8611  
Long distance calls:  
1-800-267-2130

- 13 - 36 Adelaide St. E.  
Toronto, Ont.  
M5C 1J7  
Local calls: 869-1500  
Long distance calls:  
- From area code 416, dial  
1-800-387-1700  
- From area codes 519, 705, dial  
1-800-387-1710

- 14 - 150 Main St. W.  
Hamilton, Ont.  
L8N 3E1  
Local calls: 522-8671  
Long distance calls:  
- From area code 416, dial  
1-800-263-9200  
- From area code 519, dial  
1-800-263-9210

- 15 - 166 Frederick St.  
Kitchener, Ont.  
N2G 4N1  
Local calls: 579-2230  
Long distance calls:  
1-800-265-2530

- 16 - 32 Church St.  
St. Catharines, Ont.  
L2R 3B9  
Local calls: 688-4000  
Long distance calls:  
1-800-263-5672

- 17 - 451 Talbot St.  
London, Ont.  
N6A 5E5  
Local calls: 679-4211  
Long distance calls:  
1-800-265-4900

- 18 - 185 Ouellette Ave.  
Windsor, Ont.  
N9A 5S8  
Local calls: 258-8302  
Long distance calls:  
1-800-265-4841

- 19 - 19 Lisgar St. S.  
Sudbury, Ont.  
P3E 3L5  
Local calls: 675-0581  
Long distance calls:  
1-800-461-4060

- 20 - 201 North May St.  
Thunder Bay, Ont.  
P7C 3P5  
Local calls: 623-3443  
Long distance calls:  
1-800-465-6981

### MANITOBA

- 21 - 391 York Ave.  
Winnipeg, Man.  
R3C 0P5  
Local calls: 949-6350  
Long distance calls:  
1-800-282-8079

### SASKATCHEWAN

- 22 - 1955 Smith St.  
Regina, Sask.  
S4P 2N9  
Local calls: 359-6015  
Long distance calls:  
800-552-8031

- 23 - 201 - 21st St. E.  
Saskatoon, Sask.  
S7K 0A8  
Local calls: 665-4595  
Long distance calls:  
800-772-8737

### ALBERTA

- 24 - 220 - 4th Ave. S.E.  
Calgary, Alta.  
T2G 0L1  
Local calls: 231-4101  
Long distance calls:  
1-800-332-1410

- 25 - 9820 - 107th St.  
Edmonton, Alta.  
T5K 1E8  
Local calls: 420-3510  
Long distance calls:  
1-800-232-1966 (Alta.)  
Northwest Territories and  
Northeastern B.C.  
1-800-661-5620

### BRITISH COLUMBIA

- 26 - 277 Winnipeg St.  
Penticton, B.C.  
V2A 1N6  
Local calls: 493-3616  
Long distance calls:  
1-800-642-8259

- 27 - 1166 West Pender St.  
Vancouver, B.C.  
V6E 3H8  
Local calls: 689-5411  
Long distance calls:  
112-800-663-9033  
Yukon Territory and  
Northeastern B.C.  
1-800-663-0451

- 28 - 1415 Vancouver St.  
Victoria, B.C.  
V8V 3W4  
Local calls: 388-0121  
Long distance calls:  
112-800-742-6108

**Long Distance Calls: No charge to call in Canada.**  
- For Zenith numbers, dial "0" and ask for Zenith 0-4000  
- For other numbers, dial direct

Number for  
Hearing Impaired:  
1-800-665-0354